

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

To: Members, Committee on Small Business
From: Committee Staff
Date: April 11, 2016
Re: Hearing: "Regulation: The Hidden Small Business Tax"

On Thursday, April 14, 2016 at 10:00 a.m., the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building for the purpose of examining the burden of federal regulations on small businesses. The absence of accurate and adequate information on the effects of federal regulations on small businesses makes it difficult to identify unnecessary and excessive burdens and evaluate alternative approaches that could ease those burdens. The Committee will examine the burden of federal regulations on small businesses, federal agencies' analyses of the effects of regulations on small businesses, and the need to improve those assessments.

I. Introduction

Small businesses are a significant contributor to the health and resiliency of the United States economy.¹ According to the most recent statistics, small businesses employ 56.8 million employees, or nearly half of the nation's private sector workforce.² They are responsible for 63 percent of net new private sector jobs, and produce 46 percent of private sector gross domestic product (GDP).³ Nearly 90 percent of United States employers have less than 20 employees.⁴ In 2013, 1.1 million net new jobs were created by small businesses.⁵ New and young firms are particularly important as they account for almost all net new job creation and nearly 20 percent of gross job creation.⁶ In fact, over the past 30 years, firms that are less than one-year old have annually generated an average of 1.5 million jobs.⁷

¹ The United States Small Business Administration (SBA) Office of Advocacy defines small businesses as those with 500 employees or less. SBA, OFFICE OF ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2014) [hereinafter Small Business FAQ], available at https://www.sba.gov/sites/default/files/advocacy/FAQ_March_2014_0.pdf.

² SBA, OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE: UNITED STATES 1, 3 (2016) [hereinafter United States 2016 Profile], available at https://www.sba.gov/sites/default/files/advocacy/United_States.pdf. There are 28.8 million small businesses in the United States. Of that total, 5.8 million are employers, and 23 million are non-employers. *Id.* Non-employers are businesses that have no paid employees, \$1,000 or more in annual receipts, and pay federal income taxes. <https://www.census.gov/epcd/nonemployer/view/define.html>. Non-employers are found in almost every major industry sector and include a variety of small businesses such as manufacturers, construction firms, specialty trade contractors, professional service providers, real estate agents, physicians, retailers, and home-based businesses.

³ Small Business FAQ, *supra* note 1, at 1.

⁴ Of the total number of employers in the United States, 89.49 percent have less than 20 employees. This figure was calculated by using the firm data in the United States Census Bureau's 2013 Statistics on U.S. Businesses. <https://www.census.gov/econ/sub/>.

⁵ United States 2016 Profile, *supra* note 2, at 1.

⁶ EWING MARION KAUFFMAN FOUNDATION, ENTREPRENEURSHIP POLICY DIGEST: THE IMPORTANCE OF YOUNG FIRMS FOR ECONOMIC GROWTH 1 (2015), available at <http://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/the-importance-of-young-firms-for-economic-growth>.

⁷ *Id.*

II. The Burden of Federal Regulation on Small Businesses

Federal regulations are perennially identified as a top issue for small businesses. A February 2016 survey of small business owners ranked federal regulations as the second most important problem they face after taxes.⁸ In comparison to their larger counterparts, small businesses bear a disproportionate share of the federal regulatory burden.⁹ Regulations with fixed compliance costs, such as environmental regulations that require specific pollution control equipment, may have a particularly disproportionate impact on small businesses. Small firms have less revenue and a smaller employee base than larger firms over which compliance costs can be spread.¹⁰

Between 3,000 and 4,000 final rules are issued annually. The Office of Management and Budget (OMB) 2015 Report to Congress on the Benefits and Costs of Federal Regulations and Agency Compliance with the Unfunded Mandates Reform Act estimates that regulations have cost between \$68.4 to \$102.9 billion and benefits of \$260.9 to \$981 billion over the last decade.¹¹ However, the report notes that the aggregated estimates it provides just include major rules that either have costs or benefits of \$100 million or more annually and that have a major portion of their costs or benefits monetized by the agency or OMB.¹² Thus, the report aggregates only the costs and benefits of 53 major final rules that were issued in Fiscal Year (FY) 2014.¹³ As OMB notes, “because these estimates exclude non-major rules and rules adopted more than ten years ago, *the total benefits and costs of all Federal rules now in effect are likely to be significantly larger* More research would be necessary to produce current estimates of total benefits and costs for all agencies and programs.”¹⁴

As the United States continues to struggle with a fragile and uneven recovery from the Great Recession,¹⁵ one way to measure this rebound is through new firm creation. In a flexible, non-stagnant economy there are “opportunities for businesses to enter the market or expand, but it also allows businesses to fail or contract.”¹⁶ However, the rate of new business creation has dropped by nearly fifty percent from 1978.¹⁷

⁸ NFIB SMALL BUSINESS ECONOMIC TRENDS 18 (2016), available at <http://www.nfib.com/assets/SBET-February-2016.pdf>.

⁹ W. MARK CRAIN AND NICOLE V. CRAIN, NATIONAL ASSOCIATION OF MANUFACTURERS, THE COST OF FEDERAL REGULATION TO THE U.S. ECONOMY, MANUFACTURING AND SMALL BUSINESS 1(2014) [NAM Cost of Federal Regulation], available at <http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Full-Study.pdf>. Small businesses with less than 50 employees annually spend 17 percent more than an average firm to comply with federal regulations.

¹⁰ OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, 2015 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND AGENCY COMPLIANCE WITH THE UNFUNDED MANDATES REFORM ACT 40 (2016), available at https://www.whitehouse.gov/sites/default/files/omb/inforeg/2015_cb/2015-cost-benefit-report.pdf.

¹¹ *Id.* at 10.

¹² *Id.* at 8.

¹³ *Id.* at 2, 5-6.

¹⁴ *Id.* at 18 (emphasis added).

¹⁵ According to economists, the United States experienced an economic recession from December 2007 through June 2009. NATIONAL BUREAU OF ECONOMIC RESEARCH, BUSINESS CYCLE DATING COMMITTEE REPORT 1 (2010), available at <http://www.nber.org/cycles/sept2010.pdf>. It is important to note this organization is not affiliated with the federal government. According to a January 2016 report issued by the National Association of Counties (NACO), only 7 percent of United States county economies have fully recovered to their pre-recession levels based on four indicators: jobs, unemployment rate, economic output (GDP) and median home prices. EMILIA ISTRATE, PH.D. AND BRIAN KNUDSEN, PH.D., NACO, COUNTY ECONOMIES 2015: OPPORTUNITIES AND CHALLENGES 4 (2016), available at http://www.naco.org/sites/default/files/documents/2016%20CET-report_01.08.pdf.

¹⁶ https://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=1532&

¹⁷ IAN HATHAWAY, MARK E. SCHWEITZER, AND SCOTT SHANE, FEDERAL RESERVE BANK OF CLEVELAND, THE SHIFTING SOURCE OF NEW BUSINESS ESTABLISHMENTS AND NEW JOBS 2 (2014), available at

Although there are many factors contributing to the decline of new business creation, regulations are a significant barrier to entry for new firms. Between 1997 and 2010, the industries with the least regulation “grew twice as fast as the most regulated industries.”¹⁸ In the United States, recent research suggests that a 10 percent increase in regulation leads to a 0.5 percent decrease in overall firm births.¹⁹ Notably, research comparing regulatory burdens in different countries found that stricter regulation of entry for firms has not led to “higher-quality products, better pollution records or health outcomes, or livelier competition.”²⁰ Rather, research found that “countries with stricter regulation of entry are more likely to exhibit sharply higher levels of corruption and a larger unofficial economy.”²¹ Further, for established firms in highly regulated industries, evidence suggests that regulations are responsible for lower productivity.²²

Some industries are far more regulated than others and therefore small firms in those sectors may face more significant challenges than those in other sectors. According to a recently released report by the Mercatus Center at George Mason University (GMU), the top 10 industries experiencing the most significant increase in regulation since 1997 include: 1) utilities; 2) chemical products manufacturing; 3) professional, science, and technical services; 4) securities, commodity contracts, and investments; 5) motor vehicles, bodies and trailers, and parts manufacturing; 6) Federal Reserve banks, credit intermediation, and related services; 7) forestry, fishing, and related activities; 8) petroleum and coal products manufacturing; 9) retail trade; and 10) air transportation.²³ The report identified environmental regulation and financial regulation promulgated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010²⁴ (hereinafter “Dodd-Frank”) as the two significant drivers of the increased regulation on the aforementioned industries.²⁵

Dodd-Frank provides for a comprehensive reorganization of the regulatory structure surrounding the financial services industry. It illustrates how one statute and its regulatory progeny can transform an industry. Dodd-Frank required nearly 400 new rules, and as of December 31, 2015, 267 rules had been finalized and an additional 40 proposed.²⁶ As the number of Dodd-Frank regulations increased, there has been a parallel reduction in the number of financial institutions. At the end of 2010, the Federal Deposit Insurance Corporation (FDIC) insured 7,657 commercial banks and saving institutions.²⁷ Five years later, the number of FDIC-insured banks has dropped to 6,182.²⁸ For credit unions, which are overseen by the National Credit Union Administration and insured by the National Credit Union Insurance Fund, the trend

<http://www.clevelandfed.org/research/commentary/2014/2014-15.pdf>. In 1978, there were 12 new businesses created for each existing business while in 2011 there were only 6.2 new firms created for each established business. *Id.*

¹⁸ <http://mercatus.org/publication/more-regulated-industries-experience-lower-productivity-growth>.

¹⁹ JAMES BAILEY AND DIANA THOMAS, MERCATUS CENTER, GEORGE MASON UNIVERSITY, REGULATING AWAY COMPETITION: THE EFFECT OF REGULATION ON ENTREPRENEURSHIP AND EMPLOYMENT 11 (2015), available at <http://mercatus.org/sites/default/files/Bailey-Regulation-Entrepreneurship.pdf>.

²⁰ *Id.* at 5.

²¹ *Id.*

²² <http://mercatus.org/publication/more-regulated-industries-experience-lower-productivity-growth>.

²³ PATRICK A. MCLAUGHLIN AND OLIVER SHEROUSE, MERCATUS CENTER, GMU, THE IMPACT OF FEDERAL REGULATION ON THE 50 STATES 5 (2016) [hereinafter Mercatus Federal Regulation Report], available at http://regdata.org/wp-content/uploads/2016/03/FRASE_web_v2.pdf.

²⁴ Pub. L. No. 111-203, 124 Stat. 1376.

²⁵ Mercatus Federal Regulation Report, *supra* note 23, at 9-10.

²⁶ DAVIS POLK, DODD-FRANK PROGRESS REPORT 2, 4 (4th Qtr. 2015), available at http://www.davispolk.com/sites/default/files/Q32015_Dodd.Frank_Progress.Report.pdf.

²⁷ FDIC, 2010 ANNUAL REPORT 124 (March 2011), available at <https://www.fdic.gov/about/strategic/report/2010annualreport/AR10final.pdf>.

²⁸ FDIC, STATISTICS AT A GLANCE (Dec. 2015), available at <https://www.fdic.gov/bank/statistical/stats/2015dec/industry.pdf>.

has been disturbingly similar, as at the end of 2010 there were 7,339²⁹ and by December 2015 their number had dropped to 6,021.³⁰ Further, the rate of new bank growth has slowed dramatically, resulting in only 4 new banks from 2011 through 2013, a stark contrast from 2002-2008 where they were more than 100 new banks started.³¹ The factors that lead to new entrants in the market are varied, but research suggests that after the financial crisis the additional regulatory hurdles imposed by Dodd-Frank “may be particularly burdensome for small banks that are just getting started”³² and that “an increasingly complex and uncoordinated regulatory system has created an uneven regulatory playing field that is accelerating consolidation for the wrong reasons.”³³

III. Regulatory Flexibility Act

While the aforementioned discussion highlighted one regulated industry, the issue of the effect of regulation on small firms has been a longstanding concern for Congress. In 1980, recognition that one-size-fits all regulation can impose significant burdens on small business and that small firms were underrepresented in the federal rulemaking process spurred Congress to enact the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA).³⁴ The RFA requires agencies to identify and account for the potentially excessive costs and disproportionate impacts of regulations on small businesses and examine ways to reduce unnecessary regulatory burdens.

Federal agencies must comply with the requirements of the RFA for every rule, both proposed and final, for which they must conduct notice and comment rulemaking³⁵ as required by § 553 of the Administrative Procedure Act (APA) or any other law. The RFA requires agencies to evaluate their regulatory proposals to ensure that, while accomplishing their statutory mandates, the ability of small businesses to invent, produce, compete, and expand is not hindered.

Before an agency issues a proposed rule, it must conduct a threshold analysis of the economic impact of the proposed rule. If the agency determines that the proposed rule will have a “significant economic impact on a substantial number of small entities,” it must prepare an “initial regulatory

²⁹ NCUA, 2010 YEARNED STATISTICS FOR FEDERAL INSURED CREDIT UNIONS 1, *available at* <http://www.ncua.gov/Legal/Documents/Reports/CUStat2010.pdf>.

³⁰ NCUA, OVERALL TRENDS 1 (Dec. 2015), *available at* <https://www.ncua.gov/analysis/Pages/call-report-data/Reports/Chart-Pack/chart-pack-2015-12.pdf>.

³¹ ROISIN MCCORD, EDWARD SIMPSON PRESCOTT, AND TIM SABLICK, FEDERAL RESERVE BANK OF RICHMOND, EXPLAINING THE DECLINE IN THE NUMBER OF BANKS SINCE THE GREAT RECESSION 2 (March 2015), *available at* https://www.richmondfed.org/~media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-03.pdf.

Please note the term new as used in this memo refers to a de novo entrant, which is a newly formed bank rather than a bank converting its charter, opening a new branch, or a bank that was part of holding company spinning off into independent status.

³² *Id.* at 4.

³³ MARSHALL LUX AND ROBERT GREENE, MOSSAVAR-RAHMANI CENTER FOR BUSINESS & GOVERNMENT, HARVARD KENNEDY SCHOOL, M-RCBG ASSOCIATE WORKING PAPER SERIES NO. 37, THE STATE AND FATE OF COMMUNITY BANKING 3 (2015), *available at*

http://www.hks.harvard.edu/content/download/74695/1687293/version/1/file/Final_State_and_Fate_Lux_Greene.pdf.

³⁴ The RFA uses the term “small entities,” which includes small businesses, small not-for-profit organizations, and small governmental jurisdictions. *See* 5 U.S.C. § 601(6). For the sake of simplicity, the memo will use the term “small business.”

³⁵ Notice and comment rulemaking is the process by which regulated entities can provide input to regulators on rules that are under development. The agency must publish a notice of proposed rulemaking in the Federal Register that includes relevant information including: how individuals can submit written data, view or arguments; deadlines; the legal authority under which the rule is proposed; and the proposed rule itself. 5 U.S.C. § 553(b)-(c). The number days for comment are not specified and the period can go from 7 days to 4 months. Agencies must provide and wait at least 30 days after a final rule is published before it becomes effective. *Id.* at § 553(d). There are exceptions to these requirements that are not relevant for this hearing.

flexibility analysis” (IRFA).³⁶ If the agency determines the proposed rule will not have a “significant economic impact on a substantial number of small entities,” the agency head may certify to such a conclusion and need not prepare an IRFA.³⁷ The certification statement must include a “factual basis for the certification.”³⁸ An agency is required to prepare a final regulatory flexibility analysis (FRFA) if it determines that a final rule will have a “significant economic impact on a substantial number of small entities.”³⁹

The RFA also requires agencies to conduct outreach to small businesses when a rule will have a “significant economic impact on a substantial number of small entities.”⁴⁰ The Environmental Protection Agency (EPA), the Occupational Safety and Health Administration (OSHA), and the Consumer Financial Protection Bureau (CFPB) have an additional outreach requirement for any proposed rule that requires preparation of an IRFA. Pursuant to § 609(b) of the RFA, the aforementioned three agencies must convene a small business advocacy review (SBAR) panel⁴¹ before the rule is published in the Federal Register to receive input from small businesses.⁴²

The critical element of a regulatory flexibility analysis is consideration of alternatives. Alternatives contemplated by the authors of the RFA may include separate reporting requirements or compliance standards to take account of the limited resources of small businesses. The agency may ultimately develop a tiered regulation with different requirements for entities of different sizes or decide not to regulate small businesses because they only contribute to a small portion of a problem that the agency is trying to ameliorate. Consideration of these alternatives does not require the adoption of any particular regulatory alternative.

The Chief Counsel for Advocacy of the SBA is responsible for monitoring agency compliance with the RFA and must annually report to the President and the Committees on Small Business and the Judiciary of the United States House of Representatives and Senate.⁴³ Although the RFA has been in place for over 35 years, agencies still are not complying with the law’s requirements. In FY 2015, the Chief Counsel filed 28 public comment letters with more than 15 federal agencies on proposed rules.⁴⁴

³⁶ *Id.* at § 603. An IRFA must describe the small businesses that will be affected, the impact of the proposed rule on small businesses, the compliance burdens imposed and any significant alternatives that could minimize any significant economic impacts. *Id.* at § 603(a)-(c). The terms “significant,” “substantial,” and “economic impact” are not defined in the RFA.

³⁷ *Id.* at § 605(b).

³⁸ *Id.*

³⁹ The FRFA must describe the small businesses that will be affected, the impact of the proposed rule on small businesses, the compliance burdens imposed, the significant issues raised in public comments in response to the IRFA, any comments by the Chief Counsel for Advocacy on the proposed rule, and any changes the agency made to the rule in response to the Chief Counsel’s comments. *Id.* at § 604(a)(1)-(5). It also must describe the steps an agency has taken to minimize the significant economic impact on small businesses and why each alternative that would lessen the economic impact was rejected. *Id.* at § 604(a)(6). A certification at the proposed rule stage does not mean that the agency is entitled to certify at the final rule stage. Data obtained during the notice and comment process may force an agency to rethink its decision to certify. If sufficient information is submitted to the agency that demonstrates a significant economic impact on a substantial number of small businesses, then the agency is required to prepare a FRFA.

⁴⁰ *Id.* at § 609(a).

⁴¹ The panel is comprised of a representative of the covered agency (EPA, OSHA or CFPB), a representative of the SBA’s Office of the Chief Counsel for Advocacy, and a representative from the OMB’s Office of Information and Regulatory Affairs. *Id.* at § 609(b)(3).

⁴² *Id.* at § 609(b)-(d). The panel provides small entity representatives (SERs) with a draft of the proposed rule as well as any analysis of small entity impacts and regulatory alternatives, and collects advice and recommendations from the SERs. The panel then must report on the SERs’ comments and its findings. The report is made part of the rulemaking record. *Id.*

⁴³ *Id.* at § 612(a).

⁴⁴ REPORT ON THE REGULATORY FLEXIBILITY ACT, FY 2015: ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 13272, at 22-34 (2016) [hereinafter RFA FY 2015 Annual Report], available at <https://www.sba.gov/sites/default/files/advocacy/FY15-RFA-Annual-Report.pdf>.

The top three issues addressed in those letters were regulatory alternatives to reduce the economic impact of a rule on small businesses, inadequate analysis of small business impacts, and improperly certifying a rule as not having a significant economic impact on a substantial number of small businesses.⁴⁵

IV. Agency Compliance with the RFA

As mentioned previously, an agency does not need to prepare an IRFA or FRFA if it certifies that the proposed or final rule will not have a significant economic impact on a substantial number of small entities. According to a recent study, agencies only prepared RFA analyses for approximately 8 percent of rules finalized between Fall 1996 and Fall 2012.⁴⁶ Too often, agencies certify rules as not having a significant economic impact on a substantial number of small businesses but fail to provide a factual basis as required. In addition, agencies publish IRFAs and FRFAs that have significant flaws in the economic impact analyses or lack a discussion of significant alternatives that reduce impacts on small businesses. Finally, agencies do not conduct the kind of affirmative outreach that is required under § 609 of the RFA and accordingly limit the opportunity for adequate small businesses input in the rulemaking process.

A. *Inadequate Support for Certification*

If an agency lacks the information needed to complete its threshold analysis of the proposed rule, the notice of proposed rulemaking will not provide adequate information upon which the regulated entities may comment. More importantly, it fails to alert small businesses that the proposed rule may be of consequence to them, thereby undermining the outreach requirements of § 609(a) of the RFA.

A recent example of this occurred with the controversial “Waters of the United States” or WOTUS rule. On April 21, 2014, the EPA and United States Army Corps of Engineers (Corps) proposed a rule change the scope of waters subject to federal jurisdiction under the Clean Water Act.⁴⁷ The EPA and Corps certified that the rule would not have a “significant economic impact on a substantial number of small entities.” However, the agencies failed to provide any factual basis for the certification, as required by the RFA, despite the potential consequences for small businesses.⁴⁸ Consequently, the EPA did not conduct a SBAR panel as required by § 609(b) of the RFA and did not perform an IRFA, despite the significant and direct impacts on small businesses.⁴⁹ The final rule became effective on August 28, 2015,⁵⁰ but on October 9, 2015, the United States Court of Appeals for the Sixth Circuit blocked implementation of this rule.⁵¹

⁴⁵ *Id.* at 21.

⁴⁶ Connor Raso, *Agency Avoidance of Rulemaking Procedures*, 67 ADMIN. L. REV. 65 (2015).

⁴⁷ Definition of “Waters of the United States” Under the Clean Water Act, 79 Fed. Reg. 22,188 (Apr. 21, 2014).

⁴⁸ *Id.* at 22,220. For more comprehensive discussion of this rule and its effect on small firms, please see the Committee’s hearing memorandum on *Will EPA’s “Waters of the United States” Rule Drown Small Businesses Before the H. Comm. on Small Business*, 113th Cong. (May 29, 2014), available at http://smbiz.house.gov/uploadedfiles/5-29-2014_revised_hearing_memo.pdf, and the Committee’s regulatory comment letter explaining that the proposed rule would have direct impacts on small businesses that must obtain permits from EPA or Corps for waters they would not have otherwise needed to do under the prior definition, available at http://smbiz.house.gov/uploadedfiles/11.14.2014_wotus_comment_letter_to_epa_and_corps.pdf.

⁴⁹ The agencies characterized all the costs of the rule as indirect. EPA and Corps, *Economic Analysis of the EPA-Army Clean Water Rule 1 (2015)* [hereinafter *WOTUS Economic Analysis*], available at <https://www.regulations.gov/#!documentDetail;D=EPA-HQ-OW-2011-0880-20866>. The Committee disagreed with this conclusion and discussed why the agencies were incorrect in its comment letter.

⁵⁰ Clean Water Rule: Definition of “Waters of the United States”; Final Rule, 80 Fed. Reg. 37,054 (June 29, 2015). At the final rule stage, the EPA and Corps again certified the rule as not having a significant economic impact on a substantial number of small entities. *Id.* at 37,102.

⁵¹ *State of Ohio, et al. v. U.S. Army Corps of Engin’rs, et al.*, 2015 Fed App. 0246P (6th Cir.), available at <http://www.ca6.uscourts.gov/opinions.pdf/15a0246p-06.pdf>.

B. Regulatory Flexibility Analyses and Consideration of Alternatives

There are three key elements to an agency's compliance with the RFA's regulatory flexibility analyses requirements. They are: 1) identification of the affected small businesses; 2) estimate of the costs; and 3) development of less burdensome alternatives. Unfortunately, there are instances where agencies do not adequately identify the small businesses that will be affected by the rule and do not adequately estimate the costs associated with the rule. If an agency does not identify the costs and impacts of the rule on small business, the agency may lack the information it needs to develop significant alternatives that can accomplish the objectives of the rule while minimizing the costs on small business.⁵²

Last year, the Wage and Hour Division of the Department of Labor (DOL) issued a proposed rule to revise and update the existing Fair Labor Standards Act (FLSA) regulations that implement the exemption from minimum wage and overtime pay for executive, administrative, professional, outside sales or computer employees.⁵³ Although DOL prepared an IRFA, the adequacy and accuracy has been questioned by various commenters in the proceeding.⁵⁴ While the IRFA does provide an assessment of the effects of the overtime rule for small businesses, concerns have been raised that the DOL's analysis relies on numerous assumptions, lacks detailed industry information although it is available, and appears to underestimate the costs of compliance for small employers.⁵⁵

According to DOL's analysis, the proposed rule will apply to 211,000 small establishments and affect 1.8 million workers employed by those establishments.⁵⁶ In total, the DOL expects that small entities will incur between \$134.5 to \$186.6 million in direct costs to comply with the proposed rule⁵⁷ and \$561.5 million in wage increases to workers.⁵⁸ On average, DOL estimates that an establishment will spend \$100 to \$600 in direct costs and \$320 to \$2,700 in additional payroll to workers in the first year.⁵⁹ Concerns have been raised that DOL did not use the most precise data available – data on firms – to identify the number of small businesses that would be affected, did not examine the effects on different types of small businesses by industry sub-sectors, regions, and revenue sizes, and did not assess the effects on other small entities including counties and non-profits subject to the FLSA.⁶⁰ Further, the IRFA does not analyze any regulatory alternatives that would minimize the significant economic impact on small entities.⁶¹ It is unclear whether the problems in the analysis of the overtime rule's effects on

⁵²An agency need not examine every alternative or every alternative that significantly reduces adverse consequences or provides maximum benefit to small business. *See Associated Fisheries of Maine v. Daley*, 127 F.3d 104, 115 (1st Cir. 1997).

⁵³ Defining and Delimiting the Exemptions for Executive, Administrative, professional, Outside Sales and Computer Employees, 80 Fed. Reg. 38,516 (July 6, 2015) [hereinafter the "overtime rule"].

⁵⁴ There were almost 290,000 comments filed in response to the overtime rule.

<http://www.regulations.gov#!docketDetail;D=WHD-2015-0001>.

⁵⁵ Letter from Claudia Rodgers, Acting Chief Counsel for Advocacy, SBA and Janis Reyes, Assistant Chief Counsel, Office of Advocacy, SBA, to the Hon. Thomas E. Perez, Secretary, DOL, and the Hon. David Weil, Administrator, Wage and Hour Division, DOL (Sept. 4, 2015) [hereinafter SBA Advocacy Overtime Comment Letter], available at <https://www.sba.gov/advocacy/942015-defining-and-delimiting-exemptions-executive-administrative-professional-outside>.

⁵⁶ 80 Fed. Reg. at 38,604. An establishment is "a single physical location where business is conducted or where services or industrial operations are performed." <http://www.census.gov/econ/susb/definitions.html>.

⁵⁷ *Id.* at 38,605.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ DOL used establishment data from the United States Census Bureau's Statistics of United States Businesses and made assumptions to arrive at its estimate of affected small entities. *Id.* at 38,603.

⁶¹ *Id.* at 3-7. For a more detailed discussion of the overtime rule, see *The Consequences of DOL's One-Size-Fits-All Overtime Rule for Small Businesses and their Employees: Hearing Before the Subcomm. on Investigations, Oversight and Regulations of the H. Comm. on Small Business*, 114th Cong. (2015), available at <https://www.gpo.gov/fdsys/pkg/CHRG-114hhrg96855/pdf/CHRG-114hhrg96855.pdf>.

small businesses have been addressed as DOL has not performed and published a supplemental IRFA as recommended by the SBA Chief Counsel for Advocacy.⁶² DOL submitted the final rule to OMB for clearance on March 14, 2016.⁶³

RFA non-compliance failures often stem from individual agencies interpretations of the RFA's requirements that differ from the Chief Counsel's long-standing positions. Court decisions have exacerbated this problem. For example, the United States Court of Appeals for the District of Columbia has concluded that an agency only needs to analyze the effects of a regulation on small entities that are directly subject to a regulation.⁶⁴ The EPA and the Corps relied on these decisions for rejecting the Chief Counsel for Advocacy's comments and noted that the WOTUS rule did not directly regulate any entity but was only a definitional rule.⁶⁵

C. Addressing RFA Compliance Issues

The Committees on Small Business and the Judiciary have acted to address weaknesses in the RFA and court decisions that have allowed agencies to creatively interpret its requirements to avoid compliance. Last year, Chairman Chabot introduced H.R. 527, the Small Business Regulatory Flexibility Improvements Act of 2015. The legislation would clarify and strengthen a number of the RFA's provisions. It would clarify that agencies should consider both direct and reasonably foreseeable indirect economic effects, eliminate loopholes the Internal Revenue Service and other agencies have used to avoid RFA compliance, require more detailed analyses (including an assessment of cumulative impacts of new regulations), expand opportunities for small business to provide input on regulations before they are proposed, and ensure agencies periodically review existing regulations. It also would provide the Chief Counsel for Advocacy with authority to promulgate RFA compliance regulations. This will ensure that the Chief Counsel's longstanding interpretations of the RFA are permanently memorialized in government-wide rules that all agencies must follow in complying with the RFA. H.R. 527 passed the House by a vote of 260-163 on February 5, 2015 and awaits action in the Senate.

V. Conclusion

While regulations may be required by statute and may be well-intended, they can have negative effects on small businesses. Identifying and reducing unnecessary and excessive regulatory burdens is critical for the creation of a more conducive environment for small businesses and economic growth. If agencies do not accurately and adequately assess those effects, they may finalize regulations that could make it more difficult for small firms to start, grow, and survive. Given the importance of small businesses to the nation's economy, the rulemaking process must be improved and modernized to ensure that small businesses are able to thrive and remain competitive in the United States and the global marketplace.

⁶² SBA Advocacy Overtime Comment Letter, *supra* note 55, at 8-10.

⁶³ <http://www.reginfo.gov/public/do/eoReviewSearch;jsessionid=D588BA88176A436E9DAB4CC9C4800C59>.

⁶⁴ See *Michigan v. EPA*, 213 F.3d 663, 688-89 (D.C. Cir. 2000); *American Trucking Ass'n v. EPA*, 175 F.3d 1027, 1043-45 (D.C. Cir. 1999), *aff'd in part and rev'd in part on other grounds sub nom.*, *Whitman v. American Trucking Ass'n*, 531 U.S. 457 (2001); *Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 340-43 (D.C. Cir. 1985).

⁶⁵ WOTUS Economic Analysis, *supra* note 49, at 1; see also *Regulatory Overreach: Is EPA Meeting Its Small Business Obligations: Hearing Before the H. Comm. on Small Business*, 113th Cong. 6-8 (2014) (testimony of the Hon. Bob Perciasepe, Deputy Administrator, EPA), available at <https://www.gpo.gov/fdsys/pkg/CHRG-113hhrg88925/pdf/CHRG-113hhrg88925.pdf>. The agencies interpretation is suspect. Compare *National Ass'n of Home Builders v. Army Corps of Eng'rs*, 417 F.3d 1272, 1284 (D.C. Cir. 2005) (changing scope of permit affects private parties).